



<p>Appendix A Independent Auditor's Reports and Financial Statements</p>
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**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Independent Auditor's Reports
and Financial Statements

For the Fiscal Year Ended June 30, 2008

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

For the Fiscal Year Ended June 30, 2008

Table of Contents

	<i>Page(s)</i>
Independent Auditor's Report	1-2
Financial Statements:	
Statement of Net Assets	3
Statement of Revenues, Expenses and Changes in Net Assets	4
Statement of Cash Flows	5
Notes to the Financial Statements	6-17
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Governmental Auditing Standards	18-19



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Board of Directors
State of California
Department of Technology Services
Rancho Cordova, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the State of California Department of Technology Services (Department), as of and for the fiscal year ended June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Department and do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2008, and the changes in its financial position or where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of June 30, 2008, and the changes in its financial position and its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, effective July 1, 2007, the Department implemented the provisions of Governmental Accounting Standards Board (GASB) Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The Department has not presented Management's Discussion and Analysis which accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 23, 2008, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Macior Mini & O'Connell LLP

Certified Public Accountants
Sacramento, California

October 23, 2008

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Statement of Net Assets
June 30, 2008
(Amounts expressed in thousands)

ASSETS:

Current assets:

Cash and investments	\$ 44,479
Accounts receivable	1,234
Travel advances to employees	134
Interest receivable	235
Due from other funds	79,231
Due from other governments	309
Prepaid expenses	1,103
Total current assets	<u>126,725</u>

Noncurrent assets

Construction in progress	14,689
Depreciable capital assets, net of accumulated depreciation and amortization of \$134,948	<u>43,018</u>
Total noncurrent assets	<u>57,707</u>

Total assets \$ 184,432

LIABILITIES:

Current liabilities:

Accounts payable	\$ 27,321
Deposits	5,900
Deferred revenue	41
Due to other funds	433
Due to other governments	20,074
Notes payable	10,579
Compensated absences	2,065
Other current liabilities	31
Total current liabilities	<u>66,444</u>

Noncurrent liabilities:

Compensated absences	11,217
Notes payable	25,988
Net OPEB obligation	6,816
Total noncurrent liabilities	<u>44,021</u>

Total liabilities 110,465

NET ASSETS:

Invested in capital assets, net of related debt	21,140
Unrestricted	<u>52,827</u>
Total net assets	<u>73,967</u>

Total liabilities and net assets \$ 184,432

See accompanying notes to the financials statements.

STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES

Statement of Revenues, Expenses and Changes in Net Assets

June 30, 2008

(Amounts expressed in thousands)

OPERATING REVENUE:

Charges for services	<u>\$ 203,883</u>
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OPERATING EXPENSES:

Personnel services	82,394
Services and supplies	126,167
Depreciation and amortization	<u>12,685</u>
Total operating expenses	<u>221,246</u>

Operating loss	<u>(17,363)</u>
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NONOPERATING REVENUE (EXPENSE):

Investment and interest income	1,218
Interest expense	(454)
Settlement to Federal Government	<u>(20,074)</u>
Total nonoperating revenue	<u>(19,310)</u>

Change in net assets	(36,673)
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Net assets, beginning of year	<u>110,640</u>
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Net assets, end of year	<u><u>\$ 73,967</u></u>
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See accompanying notes to the financials statements.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers/employers	\$ 207,209
Payments to suppliers	(122,071)
Payments to employees	(74,928)
Net cash provided by operating activities	<u>10,210</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Acquisition of intangible assets	(2,951)
Acquisition of capital assets	(3,036)
Principal paid on notes payable	(3,556)
Interest paid	(454)
Net cash used for capital and related financing activities	<u>(9,997)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Earnings on investments	<u>1,590</u>
Net cash provided by investing activities	<u>1,590</u>

Net increase in cash and cash equivalents	1,803
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Cash and cash equivalents, beginning of year	<u>42,676</u>
Cash and cash equivalents, end of year	<u><u>44,479</u></u>

RECONCILIATION OF OPERATING LOSS TO NET CASH

Operating loss	<u>(17,363)</u>
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation and amortization	12,685
Change in assets and liabilities:	
Accounts receivable	(127)
Travel advance paid to employees	9
Due from other funds	2,920
Due from other governments	533
Prepaid expenses	653
Accounts payable	4,043
Deferred revenue	-
Due to other funds	(368)
Other current liabilities	-
Compensated absences payable	409
Net OPEB obligation	<u>6,816</u>
Total adjustments	<u>27,573</u>
Net cash provided by operating activities	<u><u>\$ 10,210</u></u>

Noncash investing, capital and financing activities:

Capital acquisitions financed through notes payable	\$ 34,893
Capital acquisitions financed through accounts payable	699

See accompanying notes to the financials statements.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the State of California Department of Technology Services (Department), an internal service fund of the State of California (State), have been prepared in conformity with United States generally accepted accounting principles (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The accompanying financial statements are not intended to present fairly the financial position or changes in financial position and cash flows of the State of California in conformity with the accounting principles generally accepted in the United States.

Reporting Entity

The Department was established on July 9, 2005 by the Governor's Reorganization Plan that consolidated the Stephen P. Teale Data Center, the California Health and Human Services Agency Data Center, and the Department of General Services' Office of Network Services and is included in the financial reporting entity of the State of California as an internal service fund.

The Department provides business telecommunications system and technological services, including, automated information handling, system design and analysis, conversion of data, computer programming, information storage and retrieval to public agencies. Public agencies include, but are not limited to, all state and local governmental agencies in the state, including cities, counties, other political subdivisions of the state, state departments, agencies, boards and commissions, and department agencies, board and commissions of other state and federal agencies.

The Department is governed by the Technology Service Board as a self-sufficient internal service fund, and is administered by the California State and Consumer Services Agency and reports to the State Controller's Office and the Department of Finance. The Department was established to improve and coordinate the use of technology and to coordinate and cooperate with all public agencies in the state in order to eliminate duplication and to bring about economies that could not otherwise be obtained.

Measurement Focus and Basis of Accounting

The Department uses the flow of economic resources measurement focus applied on a full accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Department distinguishes operating from nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Department operations. Principal operating revenues of the Department are customer service charges for data services. The principal operating expenses are personnel, maintenance, service and supplies. Nonoperating revenues and expenses primarily consist of those revenues and expenses that are related to financing and investing.

The Department has elected under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to apply all applicable GASB pronouncements, as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board, or any Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

New Pronouncements

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other non-pension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB costs for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however the unfunded actuarial liability is required to be amortized over future periods. Application of this statement is effective for the Department's fiscal year ended June 30, 2008. The Department has elected to implement the requirements of GASB Statement No. 45 on a prospective basis. As a result, the Department has recorded its net OPEB liability and included financial statement disclosures in Note 9 regarding its participation in the State's OPEB plan.

Budgetary Process

The Department of Technology Services prepares an annual operating budget which is approved and adopted by the State Legislature and the Governor. The budget serves as an approved plan to facilitate financial control and operational evaluation.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Investments

The Department maintains its resources in the Surplus Money Investment Fund (SMIF) and operating accounts, which are part of the State Treasurer's pooled investment program. The resources of the SMIF are invested through the Treasurer's Pooled Money Investment Account (PMIA). Investments of the PMIA are restricted by State statutes and regulatory oversight is provided by the Pooled Money Investment Board. The Department's investment in SMIF is reported at amortized cost, which approximates fair value. Investment income is distributed to the Department quarterly based on the Department's relative participation during the quarter. As of June 30, 2008, the weighted average maturity of the PMIA was approximately 212 days. Neither the SMIF nor PMIA are rated. Additional information regarding investment risks, including interest rate risk, credit risk and foreign-currency risk of the PMIA can be found in the State's financial statements.

At June 30, 2008, \$38.2 million was invested in SMIF and \$6.3 million was held in the State Treasury.

For purposes of the statement of cash flows, the Department considers all amounts held in the State's investment pools to be cash and cash equivalents. Amounts held in the State's investment pools are available on demand; thus, they are considered highly liquid and cash equivalents for purposes of the statement of cash flows.

Capital and Intangible Assets

Capital and intangible software assets are stated at cost except for assets contributed to the Department, which are stated at their fair market value on the date contributed. When assets are retired or otherwise disposed of, the cost and related depreciation and amortization are removed from the accounts and any resulting gain or loss is reflected as nonoperating revenue or expense for the period. Maintenance and repair costs are expensed as incurred. Significant renewals or betterments are capitalized and depreciated or amortized over their estimated useful lives.

Depreciation and amortization of capital and intangible assets is computed under the straight-line method over the following estimated useful lives:

Equipment	5 to 10 years
Software	3-5 years

The Department's policy is to capitalize all capital and intangible assets with a cost greater than \$5,000 and a useful life of more than one year.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

Employee vacation benefits earned, but not used, are recognized as liabilities of the Department. Full-time employees vacation at rates based on length of service. Department employees are allowed to carry a maximum of 640 hours of vacation.

Sick leave benefits are earned and accumulated for each employee at a rate of 8 hours per month, following completion of one month of continuous service. There is no limit to the number of hours of sick leave that an employee may accumulate, however, upon termination an employee is not paid for unused sick leave. As such, accumulated sick leave benefits are not recognized as liabilities of the Department.

Net Assets

The difference between assets and liabilities in the Statement of Net Assets is labeled as Net Assets and is subdivided into two categories as follows:

Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation and amortization and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Unrestricted – This component of net assets consists of net assets not restricted for any project or any other purpose.

Risk Management

The Department participates in the State's insurance program, which has elected, with few exceptions, to be self-insured against loss and liability. Generally, the exceptions are when a bond resolution or a contract requires the State to purchase commercial insurance for coverage against property loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, there has been no insurance settlement in the last three years that has exceeded insurance coverage. Additional information regarding the State's risk management policies can be found in the State's financial statements.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE 2 – DUE FROM OTHER FUNDS

Due from other funds generally represents receivables from other state funds for services billed but not received. Due from other funds are owed by the following state funds:

Department of Health Services	\$ 31,979
Department of Social Services	16,525
State Controller's Office	3,718
Board of Equalization	3,328
Department of Motor Vehicles	2,635
Department of Child support	2,550
Department of Corrections	2,459
Department of Mental Health	2,372
State Teacher's Retirement System	1,755
Department of Development Services	716
Franchise Tax Board	545
Department of Unemployment Services	372
Other state customers	10,277
Total	<u>\$ 79,231</u>

Of the total amount outstanding as of June 30, 2008, \$36,315 was outstanding for over 90 days, and another \$6,655 was outstanding between 61 and 90 days. The total aged receivables over the allowable 60 days as established by Department policy totals \$42,970 or 54% of the total amount due as of June 30, 2008. Although, the aging of the receivables does not indicate an issue of collectibility (since the amounts are due from other State of California funds), it does adversely affect the Department management's ability to properly manage its cash flow, including timely payment of its expenses. The Department relies entirely on its revenue collections to maintain a 60 day working capital reserve.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 3 – CAPITAL ASSETS

The Department's capital assets consist of computer servers, central processing units, tape drives, front end processors, printers, universal power supply, computer upgrades and software. The activity for the year ended June 30, 2008 is as follows:

	Balance as of July 1, 2007	Additions	Deletions	Balance as of June 30, 2008
Non-Depreciable capital assets				
Construction in progress	\$ --	\$ 14,689	\$ --	\$ 14,689
Depreciable assets				
Equipment	124,902	23,939	--	148,841
Software	26,174	2,951	--	29,125
Total depreciable assets	151,076	26,890	--	177,966
Less: Accumulated depreciation and amortization	(122,263)	(12,685)	--	(134,948)
Total depreciable assets, net	28,813	14,205	--	43,018
Total capital assets, net	\$ 28,813	\$ 28,894	\$ --	\$ 57,707

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 4 – NOTES PAYABLE

The Department's notes payable activity for the year ended June 30, 2008 is as follows:

	<u>Balance as of July 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance as of June 30, 2008</u>	<u>Due within One Year</u>
Koch Financial Corp.	\$ 5,230	\$ --	\$ (1,273)	\$ 3,957	\$ 1,341
Comerica Leasing Corp. PO 2171	--	1,200	(25)	1,175	286
Comerica Leasing Corp. PO 2045	--	2,231	(44)	2,187	531
Comerica Leasing Corp. PO 2223	--	2,108	(48)	2,060	496
IBM Corp. PO 1996	--	5,026	(301)	4,725	1,221
De Lage Landen Public LLC PO 2325	--	9,841	--	9,841	2,551
Chase Equipment Leasing Inc. PO 1876	--	3,224	(324)	2,900	775
Chase Equipment Leasing Inc. PO 1372 Cannery	--	2,930	(704)	2,226	968
Chase Equipment Leasing Inc. PO 1372 GC	--	3,485	(837)	2,648	1,151
Chase Equipment Leasing Inc. PO 2164	--	4,848	--	4,848	1,259
Total notes payable	<u>\$ 5,230</u>	<u>\$ 34,893</u>	<u>\$ (3,556)</u>	<u>\$ 36,567</u>	<u>\$ 10,579</u>

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 4 – NOTES PAYABLE (CONTINUED)

Descriptions of the Departments' outstanding notes payable are as follows:

	Outstanding Amount
Note payable to the Koch Financial Corporation payable in monthly installments of \$126 including interest at 5.1% per annum: due April 1, 2011. Debt was incurred to acquire Department equipment.	\$ 3,957
Note payable to the Comerica Leasing (PO 2171) Payable in monthly installments of \$27 including interest at 3.3475% per annum: due May 15, 2012. Debt was incurred to acquire Department equipment.	1,175
Note payable to the Comerica Leasing (PO 2045) Payable in monthly installments of \$50 including interest at 3.47% per annum: due May 31, 2012. Debt was incurred to acquire Department equipment.	2,187
Note payable to the Comerica Leasing (PO 2223) Payable in monthly installments of \$47 including interest at 3.92% per annum: due May 31, 2012. Debt was incurred to acquire Department equipment.	2,060
Note payable to the IBM Corp. (PO 1996) Payable in monthly installments of \$110 including interest at 2.27% per annum: due March 1, 2012. Debt was incurred to acquire Department equipment.	4,725
Note payable to the De Lage Landen (PO 2325) payable in monthly installments of \$220 including interest at 3.57% per annum; due May 30, 2012. Debt was incurred to acquire Department equipment.	9,841
Note payable to the Chase Equipment Leasing (PO 1876) Payable in monthly installments of \$72 including interest at 3.35% per annum: due January 1, 2012. Debt was incurred to acquire Department equipment.	2,900
Note payable to the Chase Equipment Leasing (PO 1372 Cannery) Payable in monthly installments of \$86 including interest at 3.509% per annum: due September 30, 2010. Debt was incurred to acquire Department equipment	2,226
Note payable to the Chase Equipment Leasing (PO 1372 GC) Payable in monthly installments of \$102 including interest at 3.509% per annum: due September 30, 2010. Debt was incurred to acquire Department equipment.	2,648
Note payable to the Chase Equipment Leasing (PO 2164 GC) Payable in monthly installments of \$108 including interest at 3.33% per annum: due May 30, 2012. Debt was incurred to acquire Department equipment.	4,848
Total notes payable	<u>36,567</u>
Less current portion	<u>(10,579)</u>
Long term portion	<u>\$ 25,988</u>

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 4 – NOTES PAYABLE (CONTINUED)

The annual debt service requirements to maturity for all notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Payments</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 10,579	\$ 140	\$ 10,719
2010	10,620	729	11,349
2011	9,018	364	9,382
2012	6,350	101	6,451
Totals	<u>\$ 36,567</u>	<u>\$ 1,334</u>	<u>\$ 37,901</u>

NOTE 5 – COMPENSATED ABSENCES

The Department's compensated absences activity for the fiscal year ended June 30, 2008 is as follows:

	<u>Balance as of July 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance as of June 30, 2008</u>	<u>Due Within One Year</u>
Compensated Absences	\$ 12,873	\$ 5,381	\$ (4,972)	\$ 13,282	\$ 2,065
					--

NOTE 6 – LONG TERM COMMITMENTS

The Department has long-term future commitments for maintenance on software, hardware and copiers, purchase of commodities, consulting services, and the purchase of the generator system. These commitments are not included as a liability on the statement of net assets because payments towards these contracts are contingent on the Department's maintenance needs. The following is a schedule of such commitments.

<u>Year Ending June 30,</u>	
2009	\$ 58,915
2010	25,754
2011	2,266
2012	1,883
2013	29
Total	<u>\$ 88,847</u>

STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 7 – OPERATING LEASES

The Department leases office space under various operating leases. Total rental expense for all operating leases for the year ended June 30, 2008 was \$4,266. The future non-cancellable minimum lease payments for these leases are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2009	<u>\$ 30</u>

NOTE 8 – PENSION PLAN

Plan Description - The Department's employees participate in the Public Employee's Retirement Fund (PERF) administered by the California Public Employees' Retirement System (CalPERS). The PERF is an agent multiple-employer defined benefit retirement plan. CalPERS acts as a common investment and administrative agent for state governmental agencies within the State of California.

The PERF provides retirement, disability and death benefits based on the employees' years of service, age and final compensation. Employees who work half time or more are eligible to participate in the PERF. Employees vest after 5 years of service or after ten years for second-tier employees, and may receive retirement benefits at age 50. The payroll for Department employees covered by the PERF for the fiscal year ended June 30, 2008 was \$55,401, which represents the Department's entire payroll. These benefit provisions and all other requirements are established by State statute. Copies of CalPERS annual financial report may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, and P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS website at www.CalPERS.ca.gov.

Funding Policy - Benefits are funded by contributions from members and the Department and earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. The Department's contribution rates are determined by periodic actuarial valuation. Contribution requirements for the fiscal year ended June 30, 2008 were determined as part of the State's June 30, 2005 actuarial valuation using the entry age of normal actuarial cost method. The Department's contribution requirement for the year ended June 30, 2008 was \$9,165, which represent 16.544 percent of covered payroll. The computation of percentages for the Department and the employee is based on various factors including bargaining contracts, membership tier, pay schedule (biweekly or monthly), and participation in social security and Medicare. The authority for both benefit provisions and contribution obligations is derived from the State Employees Retirement Act of 1937, Section 31450 et seq. of the California Government Code.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 8 – PENSION PLAN (CONTINUED)

The following table shows the Department's required contributions (annual pension cost) and the percentage contributed for the past three fiscal years:

Period Ended	Annual Pension Cost (APC) (in thousands)	Percentage of APC Contributed
June 30, 2006	\$ 7,370	100%
June 30, 2007	8,316	100%
June 30, 2008	9,165	100%

NOTE 9 – POST-RETIREMENT BENEFITS (OPEB)

The State provides health care and dental benefit to annuitants of the retirement systems to which the State contributes as an employer. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. In accordance with the California Government Code, the State generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the State's contribution toward dental insurance costs, the State generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The Department participates in the State's plan on a cost sharing basis. The Department recognizes the costs of providing health and dental insurance to annuitants based on the required contribution, which is actuarially determined, and is funded on a pay-as-you-go basis.

The Department's required contributions and resulting net OPEB obligations is as follows:

Annual required contribution (ARC)	\$ 10,359
Contributions made	<u>(3,543)</u>
Increase in net OPEB obligation	6,816
Net OPEB obligation - Beginning of year	<u>--</u>
Net OPEB obligation - End of year	<u><u>\$ 6,816</u></u>

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Notes to the Financial Statements (Continued)
For the Fiscal Year Ended June 30, 2008
(Amounts expressed in thousands)

NOTE 9 – POST-RETIREMENT BENEFITS (OPEB) (CONTINUED)

The Department's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the fiscal year ended June 30, 2008 were as follows:

<u>Year Ended</u>	<u>Annual OPEB Cost</u>	<u>OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
6/30/08	\$ 10,359	34%	\$ 6,816

The OPEB liability of the department is not evaluated at the fund level. Additional disclosure detail required by Government Accounting Standards Board Statement No. 45, regarding State's post-retirement benefit plan are presented in the financial statements of the State of California for the year ended June 30, 2008.

NOTE 10 – DUE TO FEDERAL GOVERNMENT

The United States Department of Health and Human Services (HHS) completed a review of the Statewide Cost Allocation Plan, Section II in June 2008, for the fiscal year ending June 30, 2006. Based on the review, the HHS determined the Department had reserves in excess of Federal guidelines in the amount of \$37,382. The State agreed to refund \$20,074 for the Federal share of the excess reserves, which is shown as settlement to federal government in the statement of activities. Payment to the DHHS was made in full during the first quarter of the fiscal year ended June 30, 2009.



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Board of Directors
State of California
Department of Technology Services
Rancho Cordova, California

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENTAL AUDITING STANDARDS***

We have audited the financial statements of the State of California Department of Technology Services (Department), an internal service fund of the State of California, as of June 30, 2008, and for the fiscal year then ended, and have issued our report thereon dated October 23, 2008, which contained an explanatory paragraph describing that the financial statements present only the Department and do not purport to, and do not, present fairly the financial position and changes in financial position of the State of California. Our report also included an explanatory paragraph discussing the implementation of the provisions of Governmental Accounting Standards Board (GASB) Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management of the State of California Department of Technology Services and is not intended to be and should not be used by anyone other than this specified party.

Macie Mini & O'Connell LLP

Certified Public Accountants

Sacramento, California
October 23, 2008